26 October 2017

Deficit Narrowing For Now

- **Annual goods trade deficit narrows**
- **Primary product prices lifting export values**
- **Lower NZD to add more support**
- **But dairy price impulse expected to fade with prices offshore**
- **Annual goods trade deficit to widen in 2018**
- **Volume indicators bring no change to Q3 GDP thoughts**

September's merchandise trade deficit of $1,143m was wider than market expectations of a $900m deficit although not quite as wide as the $1,360m deficit we anticipated. Exports undershot market expectations while imports were a touch stronger than market. In the world of volatile monthly trade figures, these deviations are neither here nor there. In absolute terms both exports and imports were up on a year ago: exports 9.0% higher and imports up 1.4%.

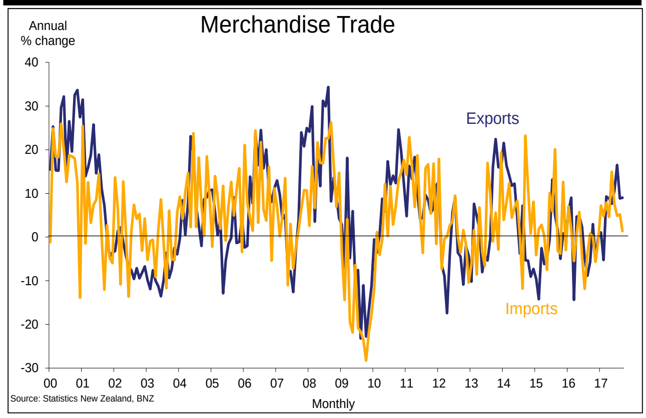
September's trade results saw the annual merchandise trade deficit continue to shrink, to $2,908m in the year to September from $3,154m in the year to August. We expect the annual deficit to continue to narrow over coming months, before widening through 2018 as dairy prices lose steam.

September's exports were boosted by dairy, with combined milk powder, butter and cheese exports up 28% on a year earlier despite a decline in volume. Higher prices, particular for butter, drove the value gains. While strong annual export growth may persist for a few months yet, supported by widespread buoyancy in primary product prices and a now lower NZD, we expect slower growth during 2018. There are already clear signs of slowdown in dairy prices appearing in recent Global Dairy Trade auction results. This will ultimately show up in export receipts ahead. It is also part of the downward pressure we see on Fonterra's current $6.75 milk price forecast. Our current forecast for Fonterra's milk price sits at $6.30.

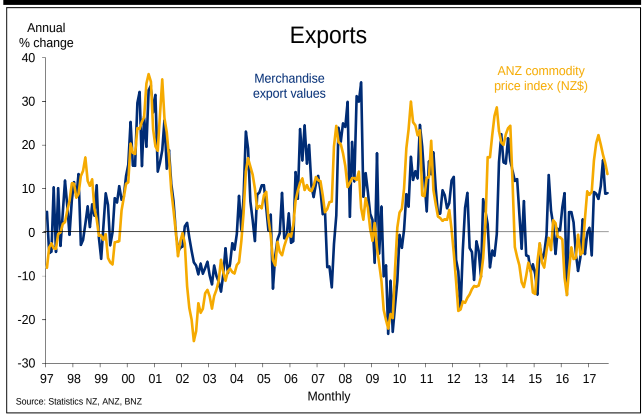
For imports, underlying annual growth is stronger than the September headline suggests. Total growth was negatively affected by the importation of large aircraft last September and unusually low oil imports this September. Excluding these components, imports were up 10% on a year ago and indicative of reasonable growth in overall domestic demand. There was double digit expansion in machinery and plant and non-oil intermediate goods. However, it is worth noting that consumption goods import growth has slowed over the past year consistent with signs that household spending growth has slowed through 2017.

Export Pick Up Narrows Annual Deficit

Exports Outpacing Imports



Buoyed By Primary Product Prices



The other trade dynamic to watch for over coming months and quarters is the influence of a lower NZD post the formation of the new government. The NZD's decline to date will put some general upward pressure on both export and import prices, other things constant, and ultimately see upward pressure on various components of the CPI. This prospect is expected to get some attention from the RBNZ at its 9 November Monetary Policy Statement.

There were no real surprises in the quarterly volume indicators in today's trade figures. Weighting together the various primary sector export components suggests a sizeable drop in Q3 export goods volumes as per the GDP accounts to be released just ahead of Christmas. This aligns with our current views. Today's import values were a bit weaker than we thought. But it is not conclusive proof that the circa 1% lift in import volumes that we have built into our Q3 GDP calculations is too high. In any case, we prefer to wait for the import volume indicators due in early December before making any adjustments. So, no change to our initial pick for Q3 GDP growth that still sits at +0.7%.

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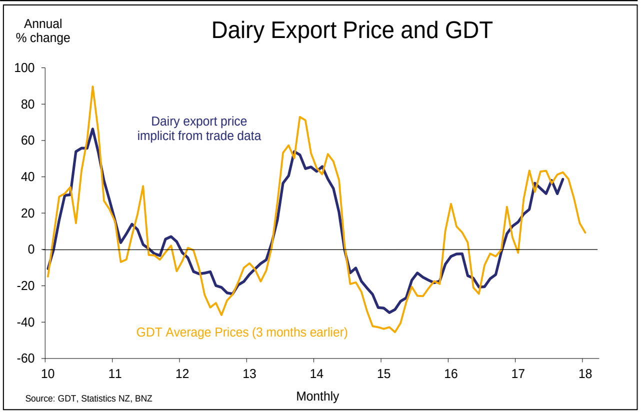
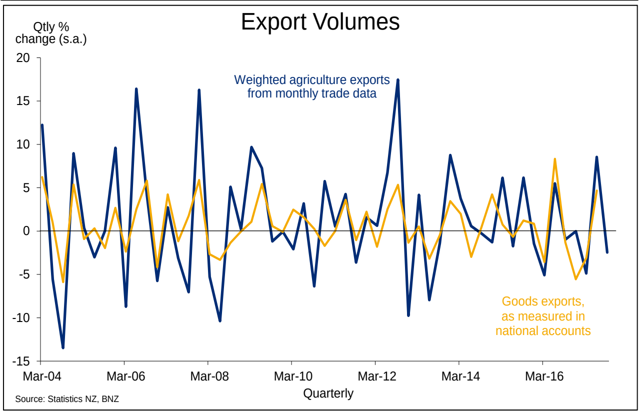
Dairy Export Price Strength to Fade



Q3 Export Volumes Likely Lower



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